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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF SECRETARY

Mr. William F. Caton
Secretary
Federal Communications Commission
1919 M Street, N.W.
Washington, D.C. 20554

Re: Policy and Rules Concerning the Interstate, Interexchange Marketplace, CC Docket No. 96-61

Dear Mr. Caton:

In its pleadings in this docket, MCI Telecommunications Corporation (MCI) has referenced comments in other proceedings and other materials relevant to the issues raised in the Commission's Notice of Proposed Rulemaking. For the convenience of the Commission, and in order to facilitate a complete analysis of the issues, MCI is enclosing two copies of each of the following items:

Comments of MCI Telecommunications Corp., Bell Operating Company Provision of Out-of-Region Interstate, Interexchange Services, CC Docket No. 96-21 (filed March 13, 1996), which were cited in MCI's Comments and Reply Comments in "Phase I" of this docket;

Comments of MCI Telecommunications Corp., Petition Requesting that Any Interstate Non-Access Service Provided by Southern New England Telecommunications Corporation Be Subject to Non-Dominant Carrier Regulation, CCB Pol 96-03 (filed Feb. 26, 1996), which were cited in MCI's Reply Comments in "Phase I" of this docket;

Robert E. Hall, Long Distance: Public Benefits From Increased Competition (Oct. 1993), which was cited in MCI's Comments in "Phase II" of this docket (a follow-up to this study was referenced in and attached to MCI's Reply Comments in "Phase II"); and

Hatfield Associates, The Cost of Basic Network Elements: Theory, Modeling and Policy Implications (March 1996), which was cited in MCI's Reply Comments in "Phase II" of this docket. (A follow-up to this study was attached to AT&T's

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Comments and Reply Comments submitted in Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, CC Docket No. 96-98).

Please include a copy of this letter and a duplicate set of all of the attached material in the public record of this proceeding.

Yours truly,

Frank W. Krogh

Frank W. Krogh

Enclosures

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

Bell Operating Company Provision of Out-of-Region Interstate, Interexchange Services	)	CC Docket No. 96-21

COMMENTS OF MCI TELECOMMUNICATIONS CORPORATION

MCI TELECOMMUNICATIONS CORPORATION

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Dated: March 13, 1996

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SUMMARY

In its Notice of Proposed Rulemaking, the Commission tentatively concludes that the BOCs' out-of-region interexchange services should be treated as "dominant" under the Competitive Carrier scheme unless they are offered through a separate affiliate, in which case, they would be treated as nondominant. MCI submits that, because of the BOCs' continuing local exchange and access market power, which can be exercised in out-of-region interexchange services, such services should be provided only through separate affiliates, and those affiliates should be regulated as dominant carriers.

The competition that is just beginning to develop in local exchange and access services has not yet had a significant effect on the BOCs' local bottleneck power. The BOCs and independent LECs still carry all but a negligible percentage of interstate access traffic. Moreover, this continuing market power can be exercised outside a BOC's service area by discriminating within its region against IXCs competing in the nationwide interexchange market. Since IXCs are dependent on the BOCs for virtually all of their access requirements, a BOC has little to lose by discriminating against them within its region in order to advantage its own interexchange services outside its region. The possibilities for anticompetitive conduct and cross-subsidies are especially great for out-of-region interexchange calls that terminate in-region.

Because of the BOCs' continuing bottleneck power and

resulting ability to leverage it in their out-of-region interexchange services, they should be allowed to offer such services only through separate affiliates. The same considerations that led the Commission to prefer separate affiliates for LEC interexchange services -- minimizing discrimination and cross-subsidies -- apply with even greater force to BOC interexchange services, whether in-region or out-of-region. The BOCs' greater abilities and incentives to discriminate and cross-subsidize require that all BOC out-of-region interexchange services be provided through separate affiliates. Similarly, all such services should be treated as dominant unless and until subsequent experience demonstrates that they can safely be granted nondominant status if they are provided through separate affiliates.

Moreover, in order to ensure that the separate affiliate requirement is effective, the Commission should also impose stringent accounting requirements. There should be a complete Part 64 affiliate transaction description in the BOCs' Cost Allocation Manuals setting out the various categories of transactions between a BOC's local exchange operations and its interexchange affiliate, as well as transactions between the interexchange affiliate and its nonregulated affiliates, in order to preclude improper cost-shifting. The BOC interexchange affiliates should also be required to maintain their books pursuant to Parts 32 and 36 of the Commission's Rules to ensure that the Commission can prevent cross-subsidization.

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

Bell Operating Company Provision of Out-of-Region Interstate, Interexchange Services	)	CC Docket No. 96-21

COMMENTS OF MCI TELECOMMUNICATIONS CORPORATION

Introduction

MCI Telecommunications Corporation (MCI), by its undersigned attorneys, hereby responds to the Notice of Proposed Rulemaking (Notice)[1] inviting comments on the Commission's proposal to regulate "out-of-region" interstate, interexchange services of the Bell Operating Companies (BOCs) as "dominant" services unless they are offered through a separate affiliate meeting the Commission's Competitive Carrier criteria.[2] MCI submits that, because of the BOCs' continuing local bottleneck power and their

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[1] Notice of Proposed Rulemaking, FCC No. 96-59 (released February 14, 1996), 61 Fed. Reg. 6607 (February 21, 1996).

[2] Policy and Rules Concerning Rates for Competitive Common Carrier Services and Facilities Therefor, CC Docket No. 79-252, Notice of Inquiry and Proposed Rulemaking (Competitive Carrier Notice), 77 FCC 2d 308 (1979); First Report and Order (First Report), 85 FCC 2d 1 (1980); Further Notice of Proposed Rulemaking, 84 FCC 2d 445 (1981); Second Further Notice of Proposed Rulemaking, 47 Fed. Reg. 17308 (1982); Second Report and Order (Second Report), 91 FCC 2d 59 (1982), recon. denied, 93 FCC 2d 54 (1983); Third Report and Order (Third Report), 48 Fed. Reg. 46791 (1983); Fourth Report and Order (Fourth Report), 95 FCC 2d 554 (1983), vacated, AT&T v. FCC, 978 F.2d 727 (D.C. Cir. 1992), cert. denied, MCI Telecommunications Corp. v. AT&T, 113 S. Ct. 3020 (1993); Fourth Further Notice of Proposed Rulemaking, 96 FCC 2d 1191 (1984); Fifth Report and Order (Fifth Report), 98 FCC 2d 1191 (1984); Sixth Report and Order (Sixth Report), 99 FCC 2d 1020 (1985), vacated sub nom., MCI Telecommunications Corp. v FCC, 765 F.2d 1186 (D.C. Cir. 1985).

ability to apply that market power in out-of-region interexchange services, it would be premature at this time to grant any BOC interexchange services nondominant regulatory status. Accordingly, BOCs should be allowed to offer out-of-region interexchange services only through separate affiliates, and those affiliates should be regulated as dominant carriers. Moreover, whether or not the Commission decides to treat such affiliates as dominant, MCI also requests that additional accounting rules be imposed on them in order to limit the danger of cost-shifting.

The Notice responds to Section 271(b)(2) of the Telecommunications Act of 1996 (1996 Act),[3/] which authorizes BOCs to provide interLATA services originating outside their service areas. Such authorization raises the issue of how such BOC services should be regulated by the Commission. The Notice recites the history of the Competitive Carrier proceeding, under which the Commission, over the years, has modified its regulation of carriers lacking market power. Dominant carriers are subject to either price cap or rate-of-return regulation, whichever is applicable, including the imposition of cost support requirements, and must file tariffs on 14, 45 or 120 days' notice. Nondominant carriers are free of rate or earnings regulation and may file tariffs on one day's notice, without cost support and with a presumption of lawfulness.

[3/] Pub. L. No. 104-104, 110 Stat. 56 (1966).

In Competitive Carrier, the Bell System was originally classified as dominant on account of the local telephone companies' local bottleneck power.[4] Divestiture and the equal access requirements of the Modification of Final Judgment (MFJ)[5] were not considered to have altered the BOCs' essential bottleneck control and resulting dominance.[6]

The Notice announces the goal of creating a regulatory framework that optimally balances the benefits of BOC participation in out-of-region interexchange services against the risks of BOC discrimination against interexchange competitors and cross-subsidization. The Commission acknowledges that the BOCs still possess local bottleneck control and that the concerns expressed in Competitive Carrier as to entities with control of local exchange facilities also providing interexchange services are therefore still valid.

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[4] First Report, 85 FCC 2d at 21-23; Fifth Report, 98 FCC 2d at 1195-1200.

[5] United States v. American Telephone & Telegraph Co., 552 F. Supp. 131 (D.D.C. 1982), aff'd mem. sub nom. Maryland v. United States, 460 U.S. 1001 (1983).

[6] Compare Fifth Report, 98 FCC 2d at 1198, n.23 (need for separate BOC interexchange affiliate on account of BOCs' continuing local exchange bottleneck) with BOC Separation Decision, cited therein (Policy and Rules Concerning the Furnishing of Customer Premises Equipment, Enhanced Services and Cellular Communications Services by the Bell Operating Cos., 95 FCC 2d 1117, 1132-36 (1983)(prior order discussing implications of MFJ equal access requirements for BOCs), aff'd sub nom. Illinois Bell Tel. Co. v. FCC, 740 F.2d 465 (7th Cir. 1984)).

In the Fourth Report and Fifth Report, the Commission concluded, however, that independent local exchange carrier (LEC) provision of interexchange services through a separate affiliate would provide some protection against the cost shifting and anticompetitive conduct that otherwise might arise on account of the LEC's control of bottleneck facilities.[7] The Commission emphasized that any entity, including LECs, providing unseparated services with "mixed" characteristics (i.e., some services in which the carrier is dominant and some in which it is nondominant), would be regulated under the more stringent standard.[8] The Commission tentatively concludes in the Notice that the separation requirements applied to independent LECs provide a useful model on which to base an interim regime for BOC out-of-region interexchange services.

The Notice states that a BOC out-of-region interexchange affiliate would need to maintain separate books of account, that it could not jointly own transmission or switching facilities with the BOC's local exchange operations and would have to obtain any BOC local exchange services at tariffed rates and conditions. The Notice also points out that LEC interexchange affiliates are treated as nonregulated affiliates under the joint cost and affiliate transaction rules and requests comment on whether the

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[7] Fourth Report, 95 FCC 2d at 575-79; Fifth Report, 98 FCC 2d at 1195-1200.

[8] Fourth Report, 95 FCC 2d at 579.

same approach should be followed with regard to BOC out-of-region interexchange affiliates.

I. THE BOCs CONTINUE TO POSSESS LOCAL BOTTLENECK POWER, WHICH CAN BE LEVERAGED INTO OUT-OF-REGION INTEREXCHANGE SERVICES

The Commission is correct in its concern that BOC out-of-region interexchange services pose a threat of anticompetitive conduct and cross-subsidization, even if the Commission does not propose a sufficiently stringent regulatory regime to address that threat. First, it is undeniable that the BOCs still retain overwhelming market dominance in local exchange and access services within their service territories. Second, it is equally undeniable that their dominance can easily be leveraged into out-of-region interexchange services against interexchange carriers (IXCs) competing on a nationwide basis.

Although the new law lays the groundwork for the development of local competition, that has not yet happened. The BOCs have been forecasting catastrophic losses from such competitive developments for some time now, but those predictions are still greatly premature. Assistant Attorney General Anne K. Bingaman stated in testimony presented in early 1994 before the House Subcommittee on Telecommunications and Finance:

> Local telephone markets are in greatest need of added competition for they are still monopolized by local companies in the old Bell System.... the Bell Operating Companies (BOCs) in most areas of the country still have a lock on local telephone traffic, carrying more than 99 percent of all

local calls in their service areas.[9/]

More than a year later, in March 1995, the Commission confirmed that the situation had not changed appreciably. Geraldine Matise, then Chief of the Tariff Division, stated that there could be no question that the "LECs continue to exercise a substantial degree of market power in virtually every part of the country and continue to control bottleneck facilities."[10/] As the Commission stated at that time, "the competitive access industry is still very small."[11/] Today, the BOCs and independent LECs still carry all but a small sliver of interstate access traffic. Competitive access providers (CAPs) have taken only about 1.3 percent of the total access market, based on MCI's own experience. The annual increase in LEC access revenues still dwarfs total CAP annual revenues.[12/] The fiber deployed by CAPs and network equipment installed by CAPs are still a small

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[9/] Statement of Anne K. Bingaman, Assistant Attorney General, Antitrust Division, United States Department of Justice, before the Subcommittee on Telecommunications and Finance, Committee on Energy and Commerce, U.S. House of Representatives, January 27, 1994.

[10/] Presentation of Geraldine Matise at Commission Agenda Meeting, March 30, 1995, in Price Cap Performance Review for Local Exchange Carriers, CC Docket No. 94-1.

[11/] FCC News, Report No. 95-__, dated March 30, 1995, at 6.

[12/] See, e.g., Texas PUC, Scope of Competition in Telecommunications Markets, at 28-35 (January 13, 1995)(total interstate CAP revenues were one-tenth of one percent of LECs' total interstate access revenues in Texas from mid-1993 to mid-1994, while LEC access revenues grew over ten percent).

fraction of the fiber and equipment installed by the LECs.[13/]

Of special significance here is the fact that this local bottleneck power can be exercised beyond the boundaries of a BOC's service area. As the MFJ Court has explained, because the interexchange market is national in scope, a BOC providing interexchange service to customers everywhere but in its own local service region can still use its bottleneck power to discriminate against other IXCs dependent on it for access within its region, "thereby damaging the competitor's service and reputation on a national basis." United States v. Western Electric Co., 1989-1 Trade Cas. (CCH) ¶68,619 at 61,266 (D.D.C. June 13, 1989). See also other cases cited in MCI's Comments to the Department of Justice concerning Southwestern Bell's request for an MFJ waiver to provide out-of-region interexchange service, a copy of which is attached hereto as Exhibit A. Since an IXC has to use a BOC's access services for virtually all of its originating and terminating traffic, the BOC would have little to lose by discriminating against the IXC within its region in order to advantage its own interexchange services originating outside its region.

Moreover, some of the out-of-region traffic the BOCs will be

[13/] See J.M. Kraushaar, FCC, Fiber Deployment Update: End of Year 1994 at 22, 35 (July 1995). Compare Connecticut Research, Local Telecommunications Competition at Table III-1 (1994) with J.M. Kraushaar, FCC, Infrastructure of the Local Operating Companies Aggregated to the Holding Company Level at 26 (April 1995).

providing will terminate in-region. As explained in Exhibit A, the ability to terminate interexchange calls within region raises many of the same bottleneck abuse issues that arise in connection with originating service. The interface between the IXC and the BOC at the terminating end of an interexchange call is becoming increasingly sophisticated, particularly with respect to signalling information. As a result, BOCs have the ability to discriminate in favor of their long distance operations in providing new interfaces at the terminating end of interexchange calls. It should be noted that the BOC facilities used to terminate such calls not only would be similar to, but also could be the same as, the facilities the BOCs use to provide in-region monopoly services, including intraLATA toll and local services (such as the official services networks). This similarity, and in some cases, identity, of facilities used for monopoly and interexchange services would greatly aggravate the risks of cross-subsidization and discrimination on the terminating end of such calls -- a portion of the call that accounts for half of the access charges associated with such calls.

In view of the serious risks to competition posed by BOC out-of-region interexchange services, such matters as the BOCs' low interexchange market shares and the presence of established interexchange rivals are beside the point. The irrelevance of such factors is reflected in the treatment of BOC and other LEC interexchange services in the Competitive Carrier proceeding.

There, the Commission found the independent LECs dominant in their unseparated offering of interexchange services in spite of their low interexchange market shares.[14]

Similarly, the Commission stated in the Fifth Report that when the MFJ's interexchange restriction is lifted, the BOCs' interexchange services would initially be treated as dominant.[15] The Commission was obviously aware in making that statement that the BOCs would be starting off with an extremely low interstate interexchange market share -- zero, in fact, for those BOCs not already providing incidental interexchange services -- but that did not alter the analysis. The advantages conferred by the BOCs' local bottleneck[16] outweighed all other factors bearing on interexchange market power, and that continuing bottleneck power applies to out-of-region interexchange services.[17] Accordingly, the BOCs' small interexchange market share and the presence of well-established interexchange competitors do not affect the BOCs' local bottleneck-derived market power in out-of-region

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[14] Compare Fourth Report, 95 FCC 2d at 575 & n.69 (low LEC affiliate interexchange market shares) with Fifth Report, 98 FCC 2d at 1198 (need for separation of LEC interexchange operations from its local exchange network).

[15] Fifth Report, 98 FCC 2d at 1198, n.23.

[16] First Report, 85 FCC 2d at 21-23; Fifth Report, 98 FCC 2d at 1195-1200.

[17] Thus, the reference in the Notice to AT&T's nondominant status and the existence of significant competition in the interexchange market does not advance the analysis, since AT&T and the other IXCs do not possess bottleneck control over local exchange facilities.

interexchange services.

II. BOC OUT-OF-REGION INTEREXCHANGE SERVICES SHOULD BE SUBJECT TO A SEPARATE AFFILIATE REQUIREMENT AND SHOULD BE REGULATED AS DOMINANT SERVICES

A. Separate Affiliates

Because of the BOCs' continuing bottleneck power and resulting ability to leverage it in their out-of-region interexchange services, MCI agrees with the Commission insofar as it proposes that such services be provided through separate affiliates. Rather than giving the BOCs a choice as to whether to provide out-of-region interexchange services through a separate affiliate or on an unseparated basis, however, with the regulatory treatment of the services dependent on which choice is made -- as the Notice proposes -- the Commission should unconditionally require the BOCs to provide such services through separate affiliates.

The rationale for the separate LEC interexchange affiliate requirement stated in Competitive Carrier -- to minimize discrimination and cross-subsidies -- applies with even greater force in the present circumstances. Each of the Regional Bell Holding Companies (RBHCs) is much larger than the typical independent LEC. Given that the Commission previously found it necessary to use a separate affiliate condition to minimize LEC

discrimination and cross-subsidies,[13] a separate affiliate requirement is certainly necessary for BOC interexchange services, within or out-of-region. Since each RBHC covers such a large service territory, its ability to apply pressure within its region in order to benefit its own out-of-region interexchange services is much greater than any LEC's ability to do so. Moreover, because each RBHC is so large and accounts for such a large segment of the local exchange and access markets, any regulatory mistake with regard to BOC interexchange services will have more far reaching consequences than in the case of the LECs' interexchange services.

All of these considerations require that the Commission take a more stringent approach with regard to BOC out-of-region interexchange services than it did previously with regard to LEC interexchange services. While the Commission could afford to let the LECs choose whether to offer interexchange services through a separate affiliate, with nondominant treatment held out as the carrot for such separation, the Commission should regulate BOC interexchange services differently at this juncture. The continuing risk of anticompetitive conduct and cross-subsidization is simply too great not to require BOCs to offer out-of-region interexchange services through separate affiliates in all cases. The Commission will be revisiting the continued

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[13] See Fourth Report, 95 FCC 2d at 575-79; Fifth Report, 98 FCC 2d at 1195-1200.

need for BOC separate interexchange affiliates under the new Section 272 of the Communications Act in any event; at that time, the Commission could take into account the BOCs' out-of-region services as part of its review.[19] For the interim period contemplated by the Notice,[20] however, separate affiliates for out-of-region interexchange services are still necessary.

The need for separate affiliates for BOC out-of-region interexchange services -- indeed, for all BOC competitive services -- is underscored by the recent critical audits of BOC and LEC affiliate transactions conducted by state and federal authorities. For example, in April 1994, the Commission and the GTE Telephone Companies (GTOCs) entered into a Consent Decree settling issues arising out of an audit of the transactions between the GTOCs and two of their nonregulated affiliates. The audit revealed that the nonregulated affiliates achieved excessive rates of return in their sales of services to the GTOCs and that the resulting excessive costs to the GTOCs were passed on to ratepayers. The terms of the Consent Decree required the GTOCs to file rate reductions, make a contribution to the United

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[19] See the new Section 272 of the Communications Act, added by Section 151 of the 1996 Act, requiring that various BOC competitive services, including in-region interexchange services, be provided through separate affiliates, and especially Section 272(f)(1), terminating the separate affiliate requirement after three years unless the Commission extends it.

[20] Notice at ¶11.

States Treasury and undertake other remedial actions.[21] Similar findings as to excessive nonregulated affiliate earnings were made in an earlier audit of transactions between BellSouth Corporation's operating companies and a nonregulated subsidiary.[22]

A month after the GTOC Consent Decree was entered, the Commission released a federal-state joint audit examining transactions between Southwestern Bell Telephone Company (SWBT) and various of its affiliates, including its parent, Southwestern Bell Corporation (SBC). The audit report found a lack of supporting documentation for time charged by SBC employees for work done for SWBT, use of an improper marketing allocator and improper use of the general allocator. The report also found that certain services provided by SBC to SWBT were improperly charged at a prevailing company rate that did not reflect actual costs. The Commission accordingly issued an Order to Show Cause why SWBT should not be found to have violated the affiliate transaction and cost allocation rules and appropriate enforcement action taken.[23]

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[21] Consent Decree Order, The GTE Telephone Operating Companies, AAD 94-35, FCC 94-15 (released April 8, 1994).

[22] BellSouth Affiliate Transaction Audit: Summary of Audit Findings (undated). See BellSouth Corporation, et al., AAD 93-127, FCC 93-487 (released Oct. 29, 1993).

[23] Southwestern Bell Telephone Co., AAD 95-32, FCC 95-31 (released March 3, 1995) (SWB Audit).

Subsequently, the Commission entered into a Consent Decree settling issues arising out of a joint federal-state audit of the transactions between the Ameritech Operating Companies (AOCs) and their affiliate, Ameritech Services, Inc. (ASI). The Joint Audit Report concluded that ASI failed to provide adequate documentation to support the assignment of many costs to the AOCs and other affiliates. The Report also alleged that certain misclassifications of costs by ASI resulted in overallocation of costs to regulated ratepayers. Under the Consent Decree, ASI agreed to make certain changes in its accounting practices and payments to the United States Treasury and to the states of Ohio and Wisconsin.[24/]

Furthermore, the cost allocation and other accounting rules are only as good as the Commission's willingness and ability to enforce them with sufficient penalties to inhibit future misallocations. That final link in the chain may be the weakest of all. Most recently, the Commission released a summary of its audit of the BOCs' accounting for lobbying costs, which found $116.5 million in misclassified lobbying costs during the period from 1988 through 1991.[25/] Moreover, the inflated access rates resulting from such misallocations were carried over into the LECs' access rates under price cap regulation. In spite of these

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[24/] Consent Decree Order, Ameritech, AAD 95-75, FCC 95-223 (released June 23, 1995) (Ameritech Consent Order).

[25/] Commission Releases Summary of Lobbying Costs Audit Findings, Report No. CC 95-65 (released Oct. 26, 1995).

egregious violations, the Commission failed to take any remedial action for the past ratepayer injuries resulting from these misallocations.[15] Its failure to take such remedial action confirms the inadequacy of the entire cost accounting regulation and audit function, since the LECs apparently have a "free shot" at any accounting violation they may wish to commit, knowing that the worst that can happen is that someday, if they are caught, they might have to correct such practices only on a going-forward basis.

The cost misallocations, excessive costs and cross-subsidies uncovered by these audits, and the Commission's limp response thereto, thus demonstrate the ineffectiveness of the cost allocation regulations in preventing LEC cross-subsidies between regulated and unregulated services. Since LEC monopoly and regulated competitive services are more similar to one another than LEC regulated and unregulated services, allocations of costs between monopoly and competitive regulated services are even more difficult to audit. Thus, the cost allocation rules, having failed at their primary mission, certainly cannot be relied upon to prevent cross-subsidies between LEC monopoly and regulated competitive services.

Moreover, price cap regulation has not dampened the incentive to misallocate costs, as shown by the continuation of

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[15] See id.

such behavior under price cap regulation.[27] Price caps have not, and cannot, remove the incentives and ability to cross-subsidize, since LECs may choose to be subject to sharing each year, which generates incentives to shift costs. The failure of cost allocation and other accounting regulations and price caps to stem such behavior reinforces the need for a separate affiliate for all BOC interexchange services.

B. Dominant Regulatory Treatment

By the same token, it would be premature to grant BOC out-of-region interexchange services nondominant treatment under any conditions at this time. The Commission should continue to regulate all BOC services, including out-of-region interexchange services provided through a separate affiliate, as dominant services. As in Competitive Carrier, if subsequent experience persuades the Commission that its regulation of BOC out-of-region interexchange services should be reduced, it could do so then. It has no basis for doing so now, however.

It should also be kept in mind that, in the foreseeable future, the Commission will be considering BOC requests to provide in-region interexchange services, which are required by

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[27] See, e.g., SWB Audit, supra, at ¶ 2 (audit covered 1989 through 1992); Ameritech Consent Order, supra, Concurring Statement of Commissioner Andrew C. Barrett (audit covered transactions in 1992).

the 1996 Act to be provided through separate affiliates.[18] The BOCs may decide to use the same affiliates that are used for their out-of-region interexchange services as the separate affiliates required by the 1996 Act for in-region interexchange services. The Commission should not be peremptorily reducing its regulation of services provided through those affiliates before it has had an opportunity to explore all of the implications of such reduced regulation for all of the interexchange services provided through the same affiliates.

For example, if a BOC affiliate were to provide in-region interexchange services on a dominant basis while providing the same interexchange services out-of-region on a nondominant basis, the dominant regulation of the in-region services would be undercut. A typical BOC would be able to offer such services on one day's notice, without cost support and free of price cap regulation, in about 85% of the nationwide interexchange market, rendering the longer notice period and cost support for the same services in-region largely irrelevant. For all of these reasons, the Commission should retain dominant carrier regulation for all BOC interexchange services at this time, whether or not such services are provided out-of-region and through a separate affiliate.

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[18] **See** n.19, **supra**.

III. BOC OUT-OF-REGION INTEREXCHANGE SERVICES SHOULD ALSO BE SUBJECT TO ADDITIONAL ACCOUNTING SAFEGUARDS

To ensure that the separate affiliate requirement is effective, the Commission must also impose stringent accounting safeguards. Moreover, the Commission must be prepared to impose additional conditions should BOC wrongdoing require such measures.

A. BOC Interexchange Affiliates Should be Subject to Effective Affiliate Transaction Requirements

The Commission first must have a clear idea of the separate interexchange affiliate's dealings with all of the BOC's other affiliates. Extensive transactions between the interexchange affiliate and its nonregulated affiliates, as well as between the interexchange affiliate and the local exchange operations, could pose a considerable threat of cross-subsidization, as illustrated by the audits discussed above.

These continuing problems demonstrate not only the need for separate BOC out-of-region interexchange affiliates and dominant regulatory treatment for such services, but also the need for strengthened Commission oversight of affiliate transactions. Such oversight requires that each BOC submit an illustrative Cost Allocation Manual (CAM) showing a complete Part 64 affiliate transaction description for its out-of-region interexchange service affiliate, setting out all of the various categories of transactions between such affiliate and all of the BOC's other

affiliates, including its nonregulated affiliates. Many of those affiliate relationships would probably parallel the relationship between the BOC's local exchange operations and its nonregulated affiliates, but that cannot always be assumed and should be spelled out in the CAM so that the costs of the BOC's interexchange services can be properly identified and to prevent the types of cross-subsidization reflected in the audits discussed above.

The Notice proposes to treat BOC interexchange affiliates as nonregulated affiliates under the joint cost rules and affiliate transaction rules. There are two problems with that approach. First, as mentioned above, the similarity between BOC local exchange and interexchange services makes cost allocations between those two operations more difficult to audit than allocations between BOC regulated and nonregulated services. Second, the proposed approach only addresses cost shifting between the BOC's local exchange operations and its interexchange operations. By treating the interexchange operations as nonregulated, such an approach leaves possible cost shifting between the interexchange operations and the BOC's nonregulated affiliates entirely unguarded.

The Commission therefore is going to have to establish a "four-way" cost allocation and affiliate transaction monitoring regime so that it can oversee the precise extent and nature of